



Billing Code: 8025-01

SMALL BUSINESS ADMINISTRATION

Community Advantage Pilot Program

AGENCY: U.S. Small Business Administration.

ACTION: Notice of extension of and changes to Community Advantage Pilot Program and request for comments.

SUMMARY: The Community Advantage (“CA”) Pilot Program is a pilot program to increase SBA-guaranteed loans to small businesses in underserved areas. SBA continues to refine and improve the design of the Community Advantage Pilot Program. To support SBA’s commitment to expanding access to capital for small businesses and entrepreneurs in underserved markets, SBA is issuing this Notice to extend the term of the CA Pilot Program, to modify the loan loss reserve requirements for CA loans, and to revise other program requirements, including certain of the regulatory waivers.

DATES: Effective Date: The changes to the CA Pilot Program identified in this Notice will be effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER], and the CA Pilot Program will remain in effect until March 15, 2017.

Comment Date: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by SBA docket number SBA-2012-0016 by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

•Mail: Community Advantage Pilot Program Comments – Office of Financial Assistance, U.S. Small Business Administration, 409 Third Street, SW, Suite 8300, Washington, DC 20416.

•Hand Delivery/Courier: Grady B. Hedgespeth, Director, Office of Financial Assistance, U.S. Small Business Administration, 409 Third Street, SW, Washington, DC 20416.

SBA will post all comments on www.regulations.gov. If you wish to submit confidential business information (CBI) as defined in the User Notice at www.regulations.gov, please submit the information to Grady B. Hedgespeth, Director, Office of Financial Assistance, U.S. Small Business Administration, 409 Third Street, SW, Washington, DC 20416, or send an email to communityadvantage@sba.gov. Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review the information and make the final determination whether it will publish the information.

FOR FURTHER INFORMATION CONTACT: Grady B. Hedgespeth, Director, Office of Financial Assistance, U.S. Small Business Administration, 409 Third Street, SW, Washington DC 20416; (202) 205-7562; grady.hedgespeth@sba.gov. For information regarding revisions to the loan loss reserve requirements, contact Brent Ciurlino, Director, Office of Credit Risk Management, U.S. Small Business Administration, 409 Third Street, SW., Washington DC 20416; (202) 205-6538; brent.ciurlino@sba.gov.

SUPPLEMENTARY INFORMATION:

1. Background

On February 18, 2011, SBA issued a notice and request for comments introducing the CA Pilot Program (76 FR 9626). The CA Pilot Program was introduced to increase the number of SBA-guaranteed loans made to small businesses in underserved markets. The February 18, 2011 notice provided an overview of the CA Pilot Program requirements and, pursuant to the authority provided to SBA under 13 CFR 120.3 to suspend, modify or waive certain regulations in establishing and testing pilot loan initiatives, SBA modified or waived as appropriate certain regulations which otherwise apply to 7(a) loans for the CA Pilot Program. On September 12, 2011, SBA issued a second notice modifying certain of those regulatory waivers in order to permit Community Advantage Lenders (“CA Lenders”) to pledge loans made under the CA Pilot Program (“CA loans”) as collateral for certain lender financings approved by SBA. (76 FR 56262).

SBA continues to refine and improve the design of the CA Pilot Program and, on February 8, 2012, SBA issued a third notice revising certain program requirements in order to, among other things, change the maximum allowable interest rate for CA loans and permit CA Lenders to contract with Lender Service Providers. (77 FR 6619). To further support SBA’s commitment to expanding access to capital for small businesses and entrepreneurs in underserved markets, SBA is issuing this fourth notice to further revise program requirements as described more fully below.

2. Comments

Although the extension of and changes to the CA Pilot Program will be effective [INSERT DATE OF PUBLICATION IN FEDERAL REGISTER], comments are solicited from interested members of the public on all aspects of the CA Pilot Program.

Comments must be submitted on or before the deadline for comments listed in the DATES section. The SBA will consider these comments and the need for making any revisions as a result of these comments.

3. Changes to the Community Advantage Pilot Program

Extension of the CA Pilot Program

The CA Pilot Program is currently set to expire on March 15, 2014. It was anticipated that this would be sufficient time to evaluate whether the CA Pilot Program was succeeding in expanding access to capital to small businesses in underserved markets and for SBA to determine whether to take the necessary steps to make the program permanent. In response to comments received from prospective applicants to the CA Pilot Program, SBA has made significant program modifications to increase the overall interest and participation in the program. However, CA Lenders have not had enough time to allow the program to gain the traction necessary to adequately measure whether the goals of the CA Pilot Program are being met. For these reasons and due to the significant investment in time and resources that is necessary to become a CA Lender, SBA is extending the CA Pilot Program through March 15, 2017.

Fidelity Insurance Requirement

When a CA Lender is approved to participate in the CA Pilot Program it is identified as either a Small Business Lending Company (SBLC) or a Non-Federally Regulated Lender (NFRL), depending on whether the lender is subject to regulation by a State. Accordingly, all CA Lenders are SBA Supervised Lenders, as that term is defined in 13 CFR 120.10, and are subject to all regulations applicable to such lenders unless

specifically waived or modified in the regulatory waiver section of the notices identified above.

Agency regulations at 13 CFR 120.470(e) require an SBLC to “maintain a Brokers Blanket Bond, Standard Form 14, or Financing Companies Blanket Bond, Standard Form 15, or such other form of coverage as SBA may approve, in a minimum amount of \$2,000,000 executed by a surety holding a certificate of authority from the Secretary of the Treasury pursuant to 31 U.S.C. 9304-9308.” SBA believes that this amount of coverage is unnecessary for most CA Lenders because the maximum amount of any one CA loan (currently \$250,000) is significantly less than the maximum amount of any one 7(a) loan (currently \$5,000,000). Therefore, SBA is modifying the regulation at 13 CFR 120.470(e) to reduce the minimum amount of coverage to \$500,000 for CA Lenders identified as SBLCs with outstanding SBA guarantee exposure of \$20 million or less. CA Lenders with outstanding SBA guarantee exposure of more than \$20 million must maintain fidelity insurance coverage in a minimum amount of \$2,000,000. SBLCs that are not CA Lenders must comply with the insurance requirement in the regulation.

Secondary Market Access

SBA is revising the approval process concerning secondary market access for CA Lenders. In the February 8, 2012 notice SBA modified the requirements for CA Lenders to sell loans in the secondary market by allowing CA Lenders to request authority “either at the time of application or after one year of participation.” (77 FR 6619). SBA is revising this requirement to allow a CA Lender to request access to the secondary market with its application to participate in the CA Pilot or at any time thereafter. If authority is not awarded as a result of the first request, the CA Lender should resolve any weakness

or deficiency indicated as reasons for rejection for secondary market authority before submitting a request for reconsideration.

Loan Loss Reserve Requirements

CA Lenders are required to create and maintain a separate Loan Loss Reserve Account (LLRA) to cover potential losses arising from defaulted CA loans. In the February 18, 2011 Federal Register Notice introducing the CA Pilot Program (76 FR 9626), SBA required all CA Lenders to create and maintain the LLRA with a reserve amount equal to 15 percent of the outstanding amount of the unguaranteed portion of a CA Lender's CA loan portfolio. This level of loan loss reserve was based on the SBA Microloan Program's loan loss reserve requirements. Upon further review, however, SBA believes that the Microloan Program is not an appropriate comparison for the CA Pilot Program because the maximum loan size in the Microloan Program is \$50,000, compared to a maximum loan size of \$250,000 permitted in the CA Pilot Program. The United States Department of Agriculture's (USDA's) Intermediary Relending Program for loans in underserved rural areas, which has a maximum loan size of \$250,000, requires a 6% cash reserve. (7 CFR 4274.332(b)(3)). SBA's Intermediary Lending Pilot Program, which has a maximum loan size of \$200,000, requires a 5% cash reserve. (13 CFR 109.350). In addition, larger commercial lenders that provide warehouse lines of credit to non-profit, mission-oriented lenders for loans to small businesses typically require a reserve rate of 5% for their riskier credits. Finally, CA Lenders must also establish an additional reserve for the guaranteed portion of loans sold into the secondary market because secondary market loan sales create a direct risk to SBA. The total cash reserve required for CA Lenders needs to be at a level that does not provide a significant

disincentive for CA Lenders to participate in the program. Therefore, SBA is revising the reserve requirement to permit CA Lenders to fund and maintain the LLRA with an amount equal to 5% of the outstanding amount of the unguaranteed portion of the CA Lender's CA loan portfolio. CA Lenders must deposit this required reserve amount in the LLRA no later than 45 days after the date of each CA loan disbursement. In order to ensure that the 5% reserve is adequate for each individual CA Lender, OCRM will review asset quality for each CA Lender as a part of the quarterly review process. This will include reviewing current delinquency and default rates, current and projected purchase rates, and risk rating for each lender. OCRM will also review compliance with the cash reserve requirements, including examination of bank statements to ensure that the reserve is adequately funded. OCRM reserves the right to increase this level in its discretion. The additional reserve requirement for loans sold on the secondary market is described in the next paragraph.

On February 8, 2012, SBA published a notice in the Federal Register that made changes to certain CA Pilot Program requirements, including among other things the requirements surrounding access to the secondary market for CA Lenders. (77 FR 6619). In that Federal Register notice, SBA stated that CA Lenders granted access to the secondary market must have additional reserves and must complete additional training in secondary market activities and requirements before initiating secondary market sales. The February 8, 2011 notice did not, however, state what the additional reserve requirement would be for CA Lenders with secondary market authority. With this Notice, SBA is establishing an additional reserve requirement of 3% of the outstanding amount of the guaranteed portion of each CA loan sold in the secondary market. This

level of additional reserve is based upon the dollar rate of repairs and denials for all 7(a) loans purchased over the last two calendar years (2.75%). Because CA Lenders are generally inexperienced 7(a) lenders, the rate is set more conservatively. CA Lenders must deposit the required reserve amount covering the guaranteed portion of the CA loan in the LLRA no later than 10 days after the CA loan has been sold in the secondary market. In addition, to address the concern that a CA Lender with an unacceptable purchase rate might use secondary market sales to significantly expand its CA loan portfolio, SBA is modifying its regulation at 13 CFR 120.660 for the duration of the pilot program, to allow the Director, Office of Credit Risk Management, discretion to suspend secondary market authority for any CA Lender based on the risk characteristics or performance of the CA Lender's portfolio.

The 5% loan loss reserve amount for the unguaranteed portion of CA loans and the 3% loan loss reserve amount for the guaranteed portion of CA loans sold in the secondary market may be kept in the same segregated bank account and must be carried as a restricted reserve on the CA Lender's balance sheet for use in meeting obligations the CA Lender has to cover losses from their CA lending activity including but not limited to defaults and guarantee repairs, denials, withdrawals or cancelations. This reserve may be used to repay SBA in the event of a repair or denial. If the CA Lender chooses to use the reserve to repay SBA, the CA Lender must ensure that the reserve is replenished to the required level within 45 days. All other requirements regarding the creation and maintenance of the LLRA stated in the February 18, 2011 notice and all subsequent notices remain unchanged. Failure to maintain the loan loss reserve account as required may result in removal from the CA Pilot Program, the imposition of

additional controls or reserve amounts, and/or other action permitted by SBA regulation or otherwise by law. Based on the risk characteristics or performance of a CA Lender, OCRM in its discretion may require additional amounts to be included in the LLRA or may suspend secondary market privileges.

Refinancing of SBA Microloans

Currently, CA loans may not be used to refinance loans made by Microloan Intermediaries in SBA's Microloan Program. Because of the natural synergies that exist between the SBA Microloan Program and the CA Pilot Program, a number of CA Lenders have asked SBA to reconsider this prohibition. The CA Pilot Program was designed as a complement to the SBA Microloan Program, especially when small business borrowers' capital needs exceed the Microloan Program's \$50,000 maximum loan limit. Allowing CA Lenders to refinance their SBA microloans or those of other Microloan Intermediaries into CA loans will not only free up microloan program resources to make more small dollar loans, but also will make both programs more attractive and thereby maximize lender participation and capital availability to underserved markets. Analysis indicates that this can be done without any significant additional risk to the 7(a) program. Loan performance data from the 7(a) loan program, (for loans less than \$250,000) over the last 10 years show virtually identical cumulative default rates for loans that went to former micro borrowers versus similarly-sized 7(a) loans that went to other borrowers (a 0.2 percent difference). Therefore, SBA is revising its policy to permit CA loans to be used to refinance loans made by SBA Microlenders subject to the policies and procedures governing debt refinancing for 7(a) loans as set forth in SBA Loan Program Requirements and the CA Participant Guide. As such, the

refinancing of same-institution debt cannot be processed on a delegated basis and must be submitted to the Standard 7(a) Loan Guaranty Processing Center. SBA will monitor the CA Pilot Program portfolio to ensure that such refinancings are in the best interest of the affected borrowers.

Financial Reports

SBA regulations at 13 CFR 120.464(b)(2) require an SBA Supervised Lender to prepare financial reports on an accrual basis. In the February 18, 2011 notice, however, SBA modified 13 CFR 120.463(a) to eliminate the requirement for CA Lenders to keep their books and records on an accrual basis. In order to be consistent with that modification, SBA is waiving 13 CFR 120.464(b)(2) for purposes of the CA Pilot Program.

CA Associate

The CA Pilot Program was originated under the basic premise that mission-based lenders are the optimal distribution tool to get capital to small businesses in underserved markets. While this premise remains true, SBA has recognized that there are many mission-based organizations that do not have the capacity to become CA Lenders but can nevertheless provide referral services to CA Lenders. Linking higher capacity CA Lenders with these other mission-based organizations should increase the flow of capital to small businesses in underserved markets. Current SBA regulations at 13 CFR Part 103 and SBA's Standard Operating Procedure (SOP) 50 10 5(E) set forth the Agency's policy and procedures governing Referral Agents and apply with equal force and effect to organizations acting as agents for CA Lenders on CA loans. Mission-based organizations providing referral services to one or more CA Lenders may be referred to as "Community

Advantage Associates” (“CA Associates”) for the purpose of the CA program and are subject to all of the same requirements as other agents. SBA may place additional reporting requirements on CA Lenders that utilize CA Associates.

Guarantee Purchase

Guarantee purchase requests for CA loans will be processed in SBA’s Commercial Loan Servicing Centers (CLSCs) in Little Rock, AR and Fresno, CA. The CLSCs, which process similarly-sized loans, have a greater capacity to receive and process additional guarantee purchase requests than the National Guaranty Purchase Center, which processes the larger and more complex standard 7(a) guarantee purchase requests.

General Information

These changes are limited to the CA Pilot Program only. All other SBA guidelines and regulatory waivers related to the CA Pilot Program remain unchanged.

SBA has provided more detailed guidance in the form of a Participant Guide which has been updated and is available on SBA’s website at <http://www.sba.gov>. SBA may provide additional guidance, through SBA notices, which may also be published on SBA’s website at <http://www.sba.gov/category/lender-navigation/forms-notices-sops/notices>. Questions regarding the CA Pilot Program may be directed to the Lender Relations Specialist in the local SBA district office. The local SBA district office may be found at <http://www.sba.gov/about-offices-list/2>.

Authority: 15 U.S.C. 636(a)(25) and 13 CFR 120.3.

Dated: October 15, 2012

Karen G. Mills,
Administrator

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